Association d’Instituts Européens de Conjoncture Economique (AIECE)

Part I

AIECE General Report

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Association d'Instituts Européens
de Conjoncture Economique (AIECE)

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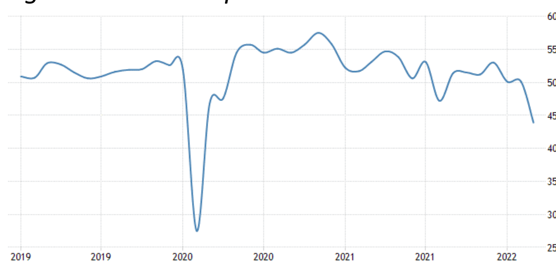
I. The External Environment

War in Ukraine a game changer… World economic prospects improved much in the first two months of 2022, mainly due to general drop of restrictiveness measures around the world (especially in the northern hemisphere), what lead to unleash of pent-up demand in services, most particular in tourism, air transport, sport, cultural and congress events etc. Since end of February, the outlook has deteriorated, largely because of Russia's invasion of Ukraine—causing a humanitarian crisis in Eastern Europe—and the sanctions aimed at pressuring Russia to end hostilities.

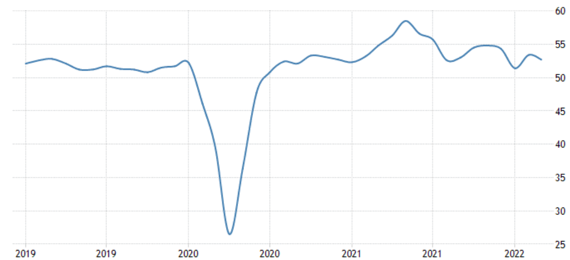
Fig. 1.1 China Composite PMI



Source: S&P Global, Investing.com

…and COVID-19 still causing pain to global economy. In addition to the war, frequent and wider-ranging lockdowns in China (about 40% of Chinese residents, mostly urban, are experiencing lockdowns most recently)—including in key manufacturing hubs—have also slowed activity there and caused new bottlenecks in global supply chains. Higher, broader, and more persistent price pressures also led to a tightening of monetary policy in many countries. Overall risks to economic prospects have risen sharply and policy trade-offs have become ever more challenging, as pressure on fiscal policy has risen, mainly to alleviate price rises for households due to rising energy and food prices.

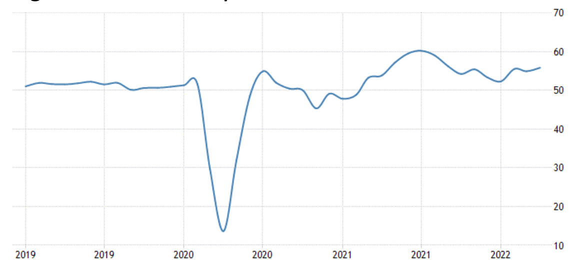
Fig. 1.2 JP Morgan Global Composite PMI



Source: JP Morgan, Investing.com

Nevertheless, have the PMIs remained reasonably high, with exception of China. **Global Composite Output Index** (JP Morgan) declined much already in January 2022 but improved in February and again declined in March and April, reaching 51.0, which indicates a slowdown in growth, which is mainly due to reduced current output in manufacturing and worser outlook in manufacturing exports. **Services indicator** (51.9 in April) slipped to its second lowest reading during last 15 months, which can be explained mainly by effect of Chinese lockdowns.

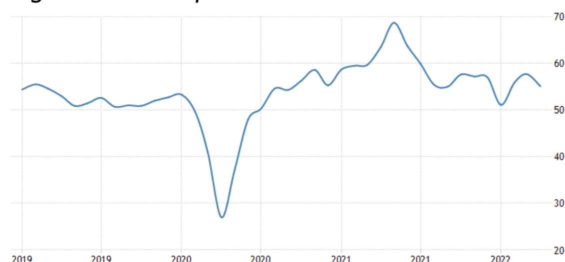
Fig. 1.3 EA19 Composite PMI



Source: S&P Global, Investing.com

Within the three world's largest economic blocks **composite PMI in EA19** (55.8 in April 2022) even increased since the beginning of the year, whereas it declined a bit in **USA** since March highs to 56 in April, mainly due to weaker sentiment in services (in contrast to EA19 where manufacturing was weaker part of the economy). **Chinese Composite PMI** dipped far below 50 in April (43.9), signalling strong contraction, that was spread evenly to services (42) and manufacturing (46). We do expect the economic circumstances in China to improve in the following months, most notably due to gradual removal of restrictions in China what we assume based on the outlook of Chinese respondents in latest PMI reading.

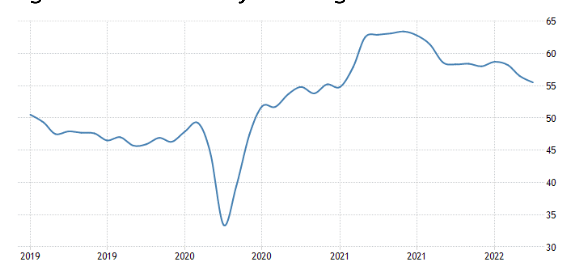
Fig. 1.4 US Composite PMI



Source: S&P Global, Investing.com

Sentiment in world's services improved much in last 2 months. **Global Sector PMI** (S&P Global) in March and April indicated that growth of output and new orders was high in **sectors** as other financials, media, tourism & recreation, industrial services, pharmaceuticals & biotechnology and telecommunication. On a declining side were mostly sectors, hit by supply chain delays and higher prices of energy, as metals and mining, construction materials, machinery & equipment (mostly in China), automobiles and auto parts as well as real estate (later probably also due to rising global interest rates).

Fig. 1.5 EA19 Manufacturing PMI



Source: S&P Global, Investing.com

Economic sentiment in EU-27 contracted since February. **ESI (Economic sentiment index)** declined since February 2022 local highs, mainly due to declining consumer confidence and industrial confidence in Europe. One must point out that level of decline is nowhere near it was in April 2020, when it declined by 46 basis points (this time it declined by 9 basis points in two months). **Services confidence** remained almost untouched at a similar level since June 2021. The level of confidence was above that in year 2019, also signalling some pent-up demand due to involuntarily savings of households due to several rounds of lockdowns.

Fig. 1.6 Real GDP estimates

GDP	2021	2022F	*vs April 2021 (in p.p.)*	2023F
World GDP	**6.1%**	**3.6%**	***-0.8***	**3.6%**
Advanced econ.	5.2%	3.3%	*-0.3*	2.4%
USA	5.7%	3.7%	*0.2*	2.3%
EA-19	5.3%	2.8%	*-1.0*	2.3%
EM and devel. ecc	6.8%	3.8%	*-1.2*	4.4%

Source: IMF, April 2022

IMF wary of geopolitical risks and change in monetary policy. In its April outlook, IMF somehow expectedly reduced its estimates for the **economic growth** and **world trade** but increased those on commodity prices and CPI. Compared to its outlook in April 2021, it reduced the estimate for global growth to 3.6 % (-0.8 p.p.). It reduced its GDP estimate for EM and developing economies (-1.2 p.p.) and EA19 (-1.0 p.p.) far more but increased the outlook for USA (+0.2 p.p.). IMF therefore expects the growth in **EM and developed economies** at 3.8% in 2022, followed by stronger growth in 2023 (+4.4%). As for the **advanced economies**, it expects the economic growth to come down from 3.3% in 2022 to 2.4% in 2023, mainly due to reduced positive effect of services in 2023. USA's growth (3.7%) should outpace that of EA19 (2.8%) in 2022, whereas in 2023, both economies should increase by 2.3%.

Fig. 1.7 World growth estimates

	2022F	2023F
Median	3.7	3.5
Max	6.1	3.9
Min	2.5	2.4

Source: AIECE Institutes

AIECE Institutes largely share the view of IMF. For the current year, AIECE Institutes[1] expect a similar slowdown in growth, expecting **world GDP** to grow by 3.7% in this year and by 3.5% in the next (median). Nevertheless, views are quite split, as the range of estimates for 2022 stands at 2.5%-6.1% and for 2023 at 2.4%-3.9%. World economy's growth is therefore more

[1] Referred as Institutes in the rest of the document.

likely to slow in next year, most probably due to lack of effect of pent-up demand spending, which is currently driving up the growth in services in developed countries as well as lower contribution of China to world growth.

Fig. 1.8 World trade volume forecasts

World trade volume	2021E	2022F	*vs April 2021 (in p.p.)*	2023F
Total (goods & services)	**10.1%**	**5.0%**	**-1.5**	**4.4%**
Exports (advanc. econ.)	8.6%	5.0%	-1.4	4.7%
Exports (EM & devel. econ.	12.3%	4.1%	-1.9	3.6%
Imports (advanc. econ.)	9.5%	6.1%	-0.3	4.5%
Imports (EM & devel. econ	11.8%	3.9%	-3.5	4.8%

Source: IMF, April 2022

World trade volume heading for significant slowdown. **World trade** probably shrank in March due to situation in Ukraine and drop in trade with Russia and Ukraine as well as due to slower throughput in Shanghai port. **Kiel Trade Indicator** for April nevertheless improved (+2.1% seasonally adjusted) and was driven by rising trade in USA and European countries. Declines in trade in China appear to be confined to the port of Shanghai as exports from China remained unchanged to March. IMF reduced its estimate for **world trade volume** (of goods and services) by 1.5 p.p. to 5% (which is also Institutes consensus for goods), a rate half of that in 2021 (10.1%), but this above long-term average growth in past few years.

Exports of advanced nations should increase by 5% in 2022 and **imports** by 6.1%, which is mainly a consequence of continuing rise in domestic consumption and investments and slowdown in exports due to reduced competitiveness of Europe in energy intensive products (this is due to high price difference between European, USA and Asian costs in electricity and natural gas). **Exports of EM and developed countries** should on other hand rise by 4.1% in 2022 and **imports** by 3.9%. A 1.9 p.p. drop in estimate of exports is mainly due to the drop in estimates for China. In 2023, world trade should rise by 4.4% according to IMF, whereas Institutes take a more cautious approach (3.7% rise).

Monetary policy is becoming more restrictive in USA due to rising prices. **The Federal Reserve** raised its **benchmark policy rate** by 0.5 p.p. in May to the range of 0.75-1.00% for the first time since 2000 and sent a strong signal that it intended to increase it by the same amount at the next two meetings. Top officials have backed a much more rapid withdrawal of the pandemic-era stimulus due to of the tightest labour markets in history and signs that price pressures are becoming entrenched and are broader. **Core inflation**, as measured by personal consumption expenditures price index, reached 5.2 per cent in March compared with the previous year. The FED will begin reducing its holdings in June using a process known as **run-off** whereby it stops reinvesting the proceeds of maturing securities.

2%-2.5% at end 2022. Institutes expect the FED's central rate to rise from current range of 0.75-1.00% to 2.00-2.25% until end of 2022 but expect the FED to take a more gradual approach to monetary tightening in 2023 (2.50-2.75% at end 2023). This may be due to the consensus that this is the neutral rate which provides optimal GDP growth and employment but also reduces the inflationary pressure. This may not be the case though. The most pessimistic Institute expect FED's rate to stand at 1.0-1.25% at end 2023, whereas the most optimistic one at 3.25-3.5%.

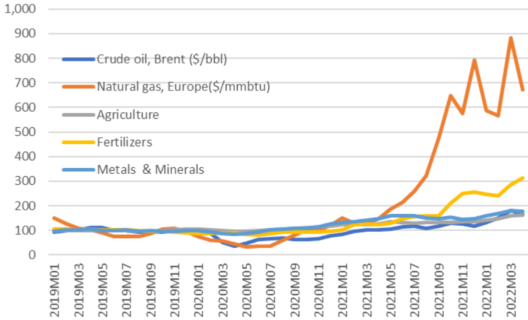
ECB taking a more gradual approach due to specific circumstances. ECB publicly announced it will take a more gradual approach to monetary tightening (compared to majority of other central banks), due to rising energy and food prices that are not a result of its policies but are based on supply issues, which are more relevant to EA19 than for USA or Asia. Financial markets now estimate the **ECB** will take its **deposit rate** from -0.5% into positive territory by the end of this year and to above 1% next year. **Eurozone HICP** rose by 7.5% y-o-y in April. Looking at the main components of euro area inflation, energy had the highest annual rate in April (38.0%), followed by food, alcohol & tobacco (6.4%),

non-energy industrial goods (3.8%) and services (3.3%).

ECB likely to stay behind the curve. Institutes agree with ECB's current outlook and are confident that the **interest rate for main refinancing operation** will increase to 0.25% at end 2022 (most probably in Q4) and will reach 0.75% at end 2023. One Institute even believes ECB will stay put and the biggest hawk expect the ECB to increase the rate to 1.5% in end 2023. Bank of Japan (BOJ) and Swiss central bank (SNB) are expected to take a very gradual steps to monetary tightening as well in response to rising inflation. BOJ is expected to go into positive territory only in beginning 2023 (currently: -0.1%) whereas SNB should go positive in Q1 2023 (current: -0.75%). BOE is expected to increase its base rate to 1.25% by end 2022 and to 1.5% by end 2023 from current level of 1% (5 May 2022).

A quite nuanced view on exchange rates. Institutes expect the **EUR/USD exchange rate** at 1.10 in end 2022 and at 1.12 in 2023. The most pessimistic (about the relative value of euro) Institute expect dollar to remain strong at 1.05 (current rate on 7 May), whereas the most optimistic one expects euro to appreciate to 1.18, what would be a 12% increase from the current exchange rate. **Pound sterling** should remain at similar levels to euro (0.84) until end 2023. There is also lack of direction between euro and **Japanese yen**, which should stay at about 125 yen for 1 euro.

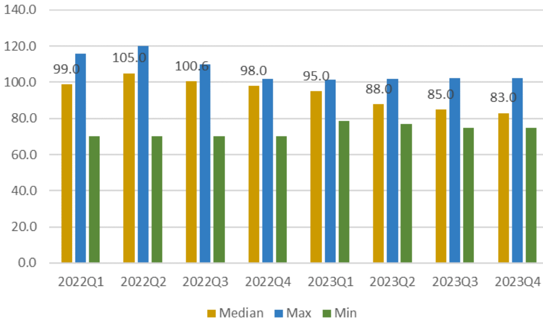
Fig. 1.9 Spot prices of selected commodities and commodity groups (2019=100)



Source: World Bank, April 2022

Brent price should come off the current highs. Institutes take a very similar view to current Brent futures prices and expect the **average price of Brent** to decrease to USD 100 in Q3 2022 and gradually to USD 83 in Q4 2023. The most bullish Institute expects Brent to remain above USD 100 until end 2023 (but not far above that price) and the most bearish one to come down to about USD 75 until end 2023.

Fig. 1.10 Brent price forecasts



Source: AIECE Institutes

Questions for discussion

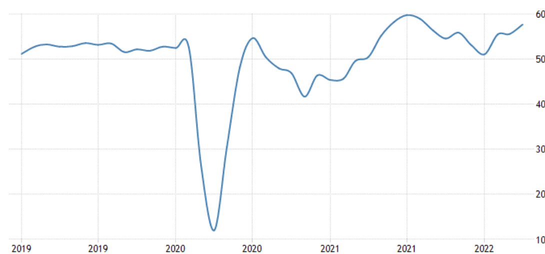
1. Will world trade be much affected by different paths of energy commodities (Russian commodities from Europe to Asia)?
2. Will global/European tourism be much affected by war in Ukraine?
3. Do you believe it is warranted that ECB will follow the FED with monetary tightening?
4. What could faster than anticipated increase in FED rate implies for EM countries that have their debt issued in USD?
5. When is it most probably to expect the supply of semiconductors for auto industry will increase to meet demand?
6. Are current lockdowns seriously hitting Chinese exports or are there any diversion of goods trade to other Chinese ports?
7. Could USD reach parity with EUR if ECB will be even more dovish about its monetary policy as currently anticipated by the markets?
8. What is the rationale for lower Brent prices? Fall in global demand or reduction in geopolitical risk?

II. The Outlook for Europe

2.1 EA-19

Growth fatigue already in Q4 2021. In the **Q1 2022**, **seasonally adjusted GDP** increased by 0.2% in the euro area. Already in Q4 2021, GDP increased only slightly (by 0.3%), after a strong growth in Q1 2021 (2.2%) and Q2 2022 (2.2%). Within EA19 economies (for which data are available), only GDP in Italy shrank (by 0.2%) in Q1 2022.

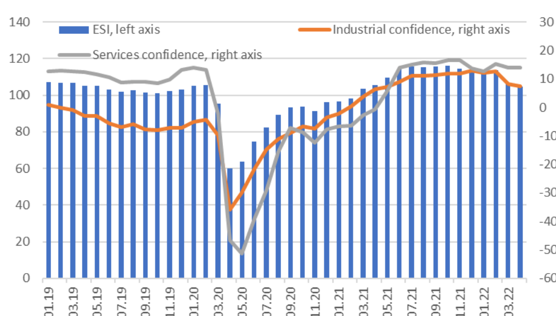
Fig. 2.1.1 EA19 Services PMI



Source: S&P Global

Services growth due to release of pent-up demand. April's **Composite PMI** (S&P Global) for **EA19** reached on April 7-month high (55.8), mainly due to increase in services sentiment (57.7) which has increased due to removal of restrictions and release of pent-up demand for services (tourism, sports, mass travel, culture etc.). In France, Spain, Italy and Germany Composite PMI was above 54, in France it climbed even to 51-month high at 57.6.

Fig. 2.1.2 Economic Sentiment Index in EU, industrial and services confidence



Source: Eurostat

Consumers feeling the punch of the war. Economic Sentiment Index (EC FIN) dropped much in March due to invasion of Ukraine, what cooled off expectations of business and consumers alike. In April, drop was lower. Consumers were the most affected group of respondents and affected also decline in **sentiment in retail trade**. In **industry**, sentiment declined due to worsening of expectations (mostly of exports and production) and probable decline of output in April (compared to March), whereas level or order book was not affected much. **Services confidence** remained largely unchanged whereas **construction confidence** fell in April due to worsening of level of order books and employment expectations, but its value remained far above long-term average. Only **consumer sentiment** dipped far below its long-term average (due to rising prices and fear of conflict) what prompted countries to increase fiscal stimulus or impose price caps etc. to cushion part of the price increases (especially in energy).

European construction sector affected by uncertainty. The EU's **Economic Uncertainty Indicator** (EUI) declined slightly in April (-0.5 points to 25.3). While uncertainty continued to rise sharply in construction (due to rising prices of material which are reducing incentive of private business to go ahead with the projects), reaching its highest level since May 2020, it remained broadly stable in retail trade and among consumers and declined somewhat in industry and services.

Producer inflation to remain high. Selling price expectations for the **next three months** rose to new record levels in all surveyed business sectors. By contrast, after having reached an all-time high in March, **consumers' price expectations for the next twelve months** dropped in April.

Industry retains view of its competitive position on non-EU markets, despite rising energy prices. The quarterly survey in European industry and services (last one in April 22) showed that **capacity utilisation in the EU industry sector** remained broadly stable at 82.3%, at rather high levels. The share of

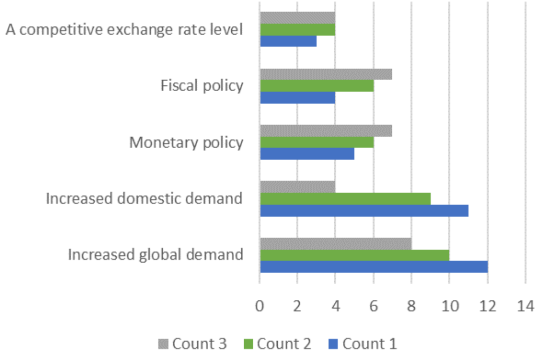
managers assessing their **current production capacity as 'more than sufficient'** (in view of current order books and demand expectations) increased (+2.8 points). On the external side, while managers' **export volume expectations** dropped markedly (-10.7 points compared to January), the **assessments of their competitive position on non-EU markets** over the past three months improved slightly (+0.5 points). Managers' appraisals of new orders, while still at a high level, declined significantly (-6.9). Nevertheless, the estimated number of months' production assured by orders on hand remained unchanged at the historically high level of 5.2 months.

Shortage of materials very material, of workers as well. Share of managers in industry reporting about **shortage of material and/or equipment** as a factor limiting production remained unchanged at the highest share on record (51.1% of all industry managers). These production constraints are compounded by a shortage of labour force, with a record 27.8% of managers (+0.3 p.p. compared to January) identifying **labour shortages** as a limiting factor for production.

Capacity utilisation in services still below pandemic level. **Capacity utilisation in services** increased by 1.5 p.p. in the EU27 (to 90.0%) compared to January. The indicator is above its long-term average (of 88.9%) but remains around half p.p. below its level before the outbreak of COVID-19 on the continent.

Service sector more upbeat about investments, manufacturing sector though more inclined to invest more. According to the survey conducted in March/April 2022 (conducted biannually), more EU **manufacturing managers** estimate to have increased their **investments** in 2021 (net balance of 24%) than in the previous survey conducted in October/November 2021 (18%). For 2022, the balance of views predicting an increase in investments compared to 2021 stood also at 24%, which represents a slight downward revision compared to the October/November 2021 survey (26%). Also, in **services** did a higher share of managers estimate to have increased their investments in 2021 (net balance of 22%) than in the previous survey conducted in October/November 2021 (20%). For 2022, the balance of views predicting an increase compared to 2021 investments stood at 22% as well, which represents a slight upward revision compared to the October/November 2021 survey (19%).

Fig. 2.1.3 Please choose the three most important factors according to their positive effect on growth in the euro area up until the end of 2022 and rank them from 1 to 3.

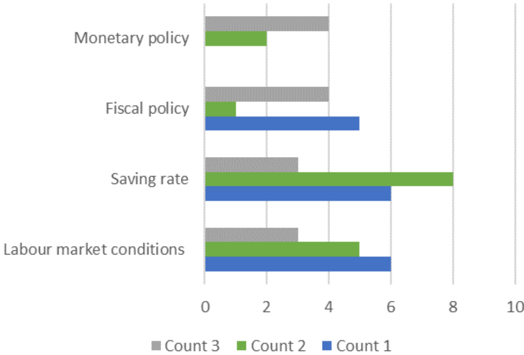


Source: Eurostat

Rising foreign and domestic demand supporting growth. Institutes expect **EA19 GDP growth** at 3.2% in 2022 (median, average is at 3.1% what implies low dispersion), ranging from 1.6% to 4.1%. In 2023, growth should fall to 2.5%, with a lower range of estimates (0.8-3.1%). Increased global and domestic demand should be two most important factors behind the growth according to special survey question. Other factors as fiscal and monetary policy or competitive exchange rate level (weaker Euro) are far less important for the growth. Majority of Institutes (88%) have made recently a **downward revision to growth in 2022** which was primarily due to two factors: external non-EU environment (Ukraine conflict) and disruption of energy commodity markets. Third factor is the possible embargo on commodity exports from Russia which is not in a central scenario for the majority of the Institutes.

Household consumption the cornerstone of growth. **Private consumption** should grow by 3.9% in 2022 and by 2.4% in 2023 indicating Institutes rely much of GDP growth to domestic consumption. Growth in **public consumption** in EA19 should namely grow in these two years by 1.5% and 1.1%. **Investments** should add more stimulus in 2023 as it is expected to grow by 3.2% in 2022 but by 3.8% in 2023.

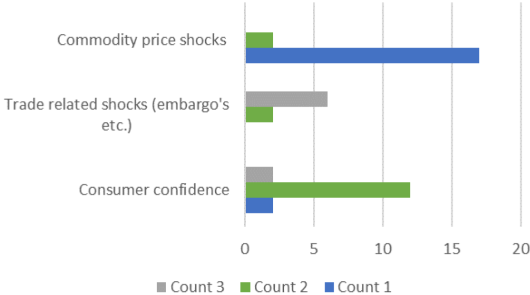
Fig. 2.1.4 Three most important factors according to their positive effect on private consumption in your country up until the end of 2022. Ranked from 1 to 3, being 1 the most important.



Source: Eurostat

Strong labour market, declining saving rate and fiscal spending the central pillars of growth. **Three most important factors that will have a positive effect on domestic consumption** are savings rate, labour market conditions and fiscal policy. The interplay between them warrants the estimated outlook for household spending, despite growing inflation that is not matched by the wage growth. Falling savings rate and decline in cash buffers should help the households weather the inflation storm and fiscal policy should provide the optimism by using its tools to address the vulnerable household groups.

Fig. 2.1.5 Three most important factors according to their negative effect on private consumption in your country up until the end of 2022. Ranked from 1 to 3, being 1 the most important.



Source: Eurostat

Commodity price shocks and consumer pessimism as two single biggest worries of Institutes. An overwhelming majority of Institutes agrees on commodity price shock to be the driving factor of the **negative effect on domestic consumption**. This is followed by declining consumer confidence. Trade related shocks are far less expected to reduce the rate of growth (embargo's etc.).

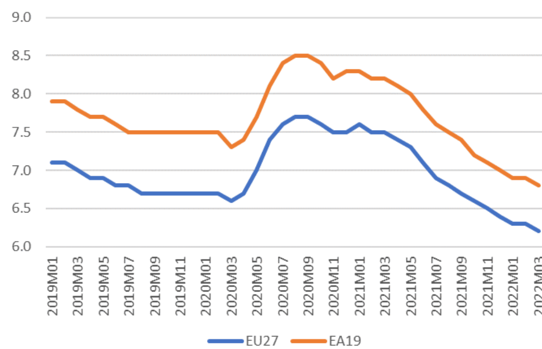
Public investments not far above usual levels. Three quarters of Institutes are confident about the **investment growth in their country** but believe that private investments are in line with normal ones in the business cycle (40%), whereas one third think that public investments are weak. One third of them believes that public investments are strong or very strong, whereas for private investments they are a bit less optimistic (30%).

Lack of inputs remains a mainstream's worry. Within next two years, Institutes put **availability of inputs and geopolitical risks** at the forefront of all the risks to their outlook. This is followed by weaker business perspectives and weak external demand. On the other side, Institutes do not expect the public expenditure to be the factor, as this was the least worrisome for them from 9 risks listed.

2.2 Labour market

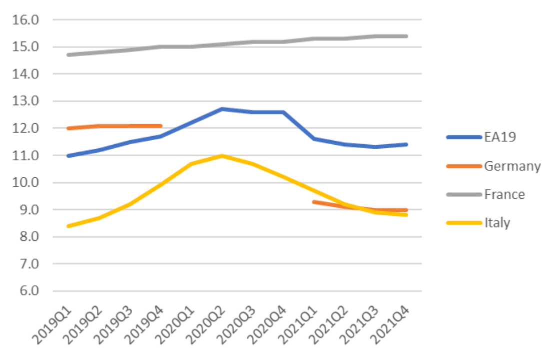
Labour market likely to remain strong. In March 2022, the EA19 **seasonally adjusted unemployment rate** was at 6.8% (6.2% in EU), down from 8.2% in March 2021. This is also the central estimate for the 2022 according to Institutes. Despite all the headwinds to economic growth, unemployment rate should come down even in 2023 (6.5% in EA19 and 5.9% in EU). The dispersion of estimates across Institutes is not big, for 2022 at 6.4%-7.9% for EA19 and for 2023 at 6.3-7.7%.

Fig. 2.2.1 Unemployment rate (ILO), monthly, trend cycle data



Source: Eurostat

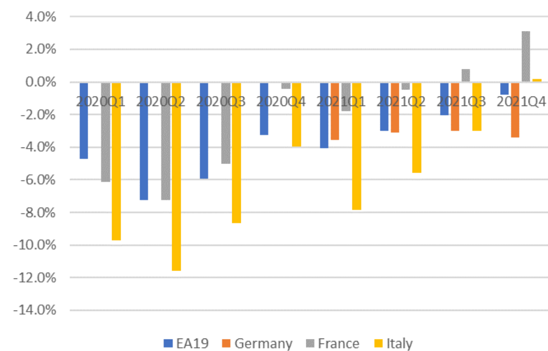
Fig. 2.2.2 Total absences from work (trend cycle data, % of total employment)



Source: Eurostat

Absences of work due to pandemic likely to subside. Data on **total absences from work** shows that it increased much in 2020 but declined in 2021. Data for Q1 2022 will probably show an additional increase due to latest round of COVID-19 pandemics absences. Absences from work has further exacerbated lack of workers as limiting factor in production and services.

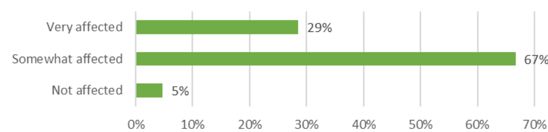
Fig. 2.2.3 Total actual hours worked in main job, compared to same quarter 2019



Source: Eurostat

Hours of work in EA19 close to pre-pandemic level in Q4 2022. **Total actual hours of work** were in 2021 2 % below the ones in 2019, but already in Q4 2022 they were at similar levels as in 2019 with France exceeding the other two large EA19 economies.

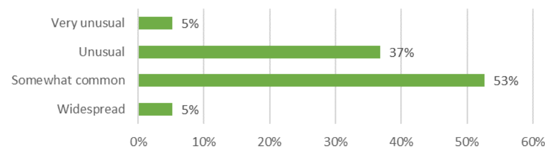
Fig. 2.2.4 To what extent would you say that your country is affected by a shortage of appropriate labour (mismatch in the labour market)?



Source: AIECE Institutes

There is room for improvement of activity rates. Despite low unemployment, 36% of Institutes believe that **measures to increase the activity rate** are insufficient (compared to 41% that believe they are appropriate). Two thirds of them believe that their domestic labour market is affected by shortage of appropriate labour, whereas 30% believe it is very affected. **Employment rates** were in Q4 2021 already above pre-pandemic level (+1.3 p.p. in EA19), most notably in Germany (+1.7 p.p.).

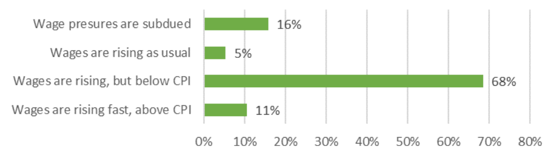
Fig. 2.2.5 What is your perception of the extent of workers on temporary/zero-hour contracts (precarious jobs) in your country?



Source: AIECE Institutes

Less widespread precarious work. With improved labour market conditions, **importance of workers on temporary/zero-hour contracts** declined. This is the case according to Institutes. Just about half of them believes this is somehow common in their country, but 37% claim it is unusual.

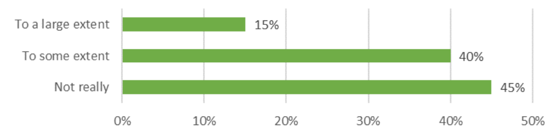
Fig. 2.2.6 What is your perception of wage dynamics in your country?



Source: AIECE Institutes

Wage growth not meeting CPI growth. Majority of Institutes (68%) estimate that **wages** in their country are not following the rise in prices. One sixth of them believes wage growth is subdued (rising very slow) and only one tenth believe wage growth is outpacing inflation. Declining real wages are not a problem for 45% of Institutes, 40% believe this is a challenge to some extent and only 15% estimate this is a big challenge. Eurostat data shows that **annualised labour cost growth** in EA19 slowed to 1.9% in Q4 2021, a slowdown from 2.3% growth in the Q3 2021.

Fig. 2.2.7 Is declining real wages an increasing problem in your country, and if so to what extent?



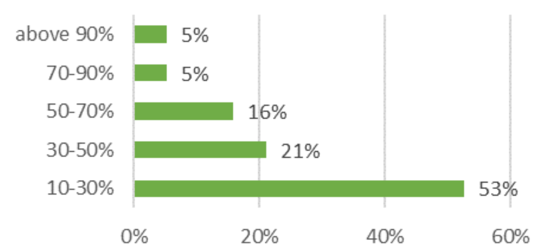
Source: AIECE Institutes

No consensus about low unemployment for whatever the price. On question about "**whether fiscal policy on the EU level** (like "Temporary framework for covid-19") should again **intervene with expansionary measures in the case of increasing unemployment**" 44% of Institutes support this and 56% do not.

2.3 Inflation

Inflation likely to calm down in the coming months. **Annual average HICP in EA19** should be at 5.5% (5.8% in EU27) in 2022, implying that Institutes believe the inflation rate to turn downwards in the following months (implied by the fact that the inflation for the first 4 months is known by know). In 2023, average inflation should fall to 2.4%, with quite some dispersion of estimates among Institutes (1.2-2.9%).

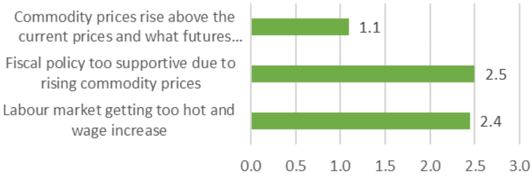
Fig. 2.3.1 What is the probability that consumer prices (measured by HICP Index) in your country will be at least 1 p.p. higher in 2022 than in your own current central estimates?



Source: AIECE Institutes

Half of Institutes very confident in their inflation estimates. The **probability that HICP will be by 1 p.p. higher than their current estimate** is between 10% and 30% for half of Institutes. A fifth of them believes that the probability is between 30% and 50% and one sixth that the odds are between 50% and 70%.

Fig. 2.3.2 What are the main factors that may contribute to increase HICP in 2022 above your current central estimates? Rank them from 1 to 3, where 1 is the most important.



Source: AIECE Institutes

Commodity prices the X factor. The far most likely **reason that HICP could exceed the current estimates** are the commodity prices. This is followed by labour market getting too hot that would affect the wages and fiscal policy becoming too supportive. These two reasons are far less important as the first one.

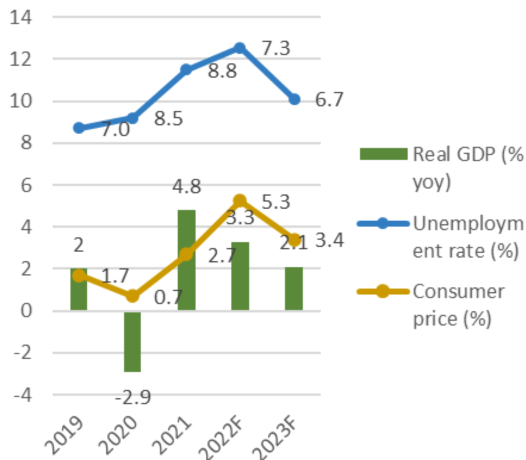
Higher inflation due to war in Ukraine. **Due to war in Ukraine**, half of Institutes increased its **average inflation target for 2022** between 1 and 2 p.p. One fifth of them increased it by 2-3 p.p. and two Institutes even by 3 p.p. or more.

Questions for discussion

1. Is the COVID-19 pandemic over or what are the odds that EU could relaunch Temporary Framework?
2. Is rising defence expenditure reducing the current account of EA19/Europe? How likely is it that fiscal policy will need to take into account this factor in 2022 and 2023?
3. Labour market is a lagging business cycle indicator. Demand for labour is strong and number of unfilled vacancies is high. Is there a possibility that unemployment remains low for long, indicating structural forces in play (negative natural rate)?
4. Is inflation expected to affect also services, where demand is currently very strong (strong tourism season is granted)?
5. To what extent does strong consumer demand offer the providers of services/retailers to increase their margins further (that is more than just passing the inflation to end consumers)?
6. How long could consumer spending keep such a pace if real incomes are generally declining due to high inflation?
7. Is higher inflation much influencing the labour wage bargaining this year in Europe?

2.4 Non-EA-19

Fig. 2.4.1 Real GDP, consumer prices and unemployment rate for Sweden

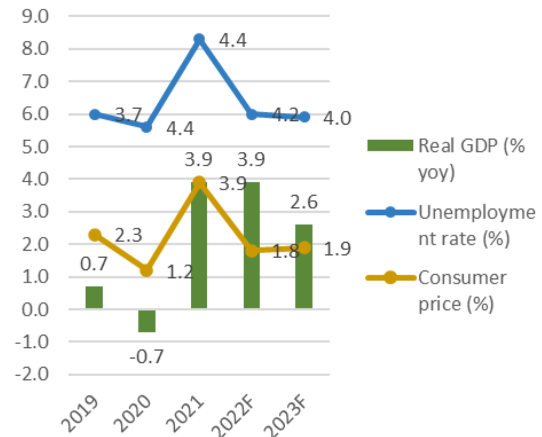


Source: Eurostat, NIER

Sweden

Government spending boosted by arrival of refugees. Economic growth in 2022 should reach 3.3% and in 2023 2.1%. In 2022 it will be led by growth in private investments (3.7%) and exports (4.4%) whereas also growth of investments will grow by 3.5%. Private investments growth is expected so slow down remarkably in 2023 (to 1.1%), whereas export growth should remain high (4.2%). Investments will grow by 2.5%, led by government investments. Growth in consumer prices is expected to be slightly slower (5.3% in 2022) than in EA-19 but above it in 2023 (3.4%). Around 200,000 Ukrainian refugees are expected to come to Sweden this year, resulting in a substantial increase in government consumption expenditure. Public finances are strong, however, and the main challenges in the short-term concerning the refugees will be practical rather than financial.

Fig. 2.4.1 Real GDP, consumer prices and unemployment rate for Norway

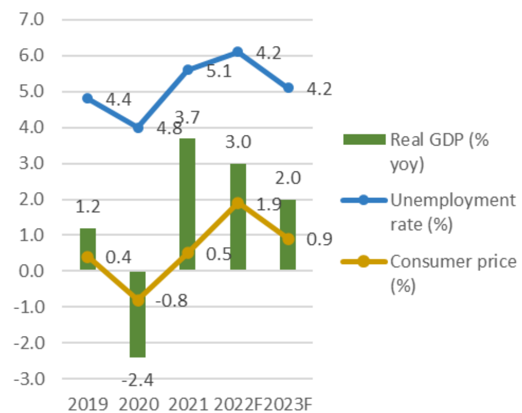


Source: Eurostat, Statistics Norway

Norway

Construction of dwellings an important driver of growth, inflation under control. Estimated economic growth in 2022 (3.9%) will be supported by remarkable rise in private consumption (6.9%) and strong export growth (6.7%), whereas public consumption (1.7%) and investment growth (0.8%) will increase only marginally. GDP growth in 2023 (2.6%) will be led by private consumption (3.1%) and exports (4.1%), whereas investments will rise as well (3.1%), mostly supported by continued rise in construction of dwellings. Consumer prices should rise only gradually, reaching 1.8% on average in 2022 and 1.9% in 2023.

Fig. 2.4.1 Real GDP, consumer prices and unemployment rate for Switzerland



Source: Eurostat, KOF Swiss Economic Institute

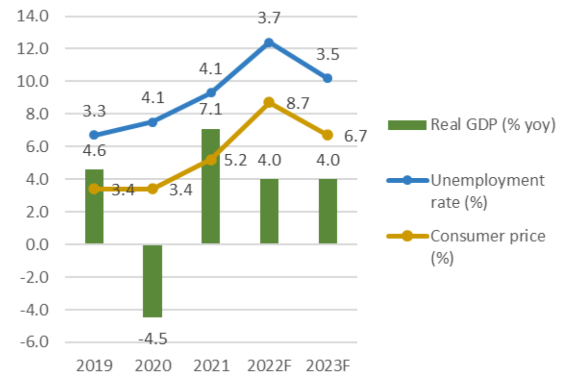
Switzerland

Consumers at home and abroad vital for growth. Switzerland's economic growth in 2022 (3%) will rely even more on private consumption (4.6%) as public consumption is expected to shrink (-2.6%) and rise in investments will only be gradual (1.1%). External environment for exports should continue to support exports as they are expected to rise by 6.3%. In 2023, fiscal policy is likely to remain restrictive, as public consumption is expected to drop 1.9%. Meanwhile private consumption growth (3.0%) should remain supportive to growth and export growth should remain high (5.0%). The economic recovery in the wake of measures to contain the spread of the COVID-19 virus, which have been relaxed or lifted altogether in many places, is thus currently being weighed down by new negative shocks. For the short term, the dominant impact of the war on the economy is the marked rise in energy and commodity prices, which further reinforces the increases in price levels already observed in many places. Trade with Russia has come to a virtual standstill in all areas except energy. For the Swiss economy, this is compounded by the fact that, as a major domicile of companies active in international commodity trading, it could lose significant added value in the event of further, more comprehensive and effective embargoes. Finally, uncertainty about the risk of further escalations, including military attacks on other states in the region, could have a negative impact on the propensity to consume and invest.

Hungary

Real growth in wages despite high pressure on prices. Economic growth in Hungary is expected to remain strong in 2022 and 2023 at about 4%, with differing drivers. In 2022, private consumption is expected to grow by 5.2%, followed by lower growth in 2023 (3.5%).

Fig. 2.4.1 Real GDP, consumer prices and unemployment rate for Hungary



Source: Eurostat, Kopint-Tárki

Growth of investments is expected to pick up much (from 4% in 2022 to 5.2% in 2023) what also holds for exports (rise from 4% to 5.3%), signalling increased supply of semiconductors for auto industry. Average consumer prices are expected to rise in 2022 by 8.7% and by 6.7% in 2023, but nominal hourly gross wage are expected to rise even more (12.3% and 9.0%) which is quite a unique situation among countries. The Hungarian economy was hit by the Russian-Ukrainian war and the related sanctions, primarily through the supply chain and growing difficulties to obtain the necessary materials and parts, and the rising energy and raw material prices. This affected industrial production and exports that had already suffered from the shortage of semiconductors and other inputs. These difficulties are compounded by the upsurges of the pandemic in various crucial industrial and commercial hubs within China, where the authorities strive to halt the spread of the infections by stringent lockdown measures. Domestic construction sector is hit by the rising cost and scarcer availability of the necessary building materials.

Questions for discussion

1. What is the probable economic effect of influx of Ukrainian refugees on economy of Poland and Sweden? How likely is it that they remain in this country and add to labour force?
2. How will the UK economy fare with current challenges (high energy and food prices)? Are there any signs that they are economically decoupling from EU27? Is there any potential for renewal of tension between UK and EU-27 due to the border mechanism in Northern Ireland?
3. Is Turkey a likely winner of reshoring and shortening of value chains? What about the CEE countries?
4. Which countries will be must hurt by oil embargo and what kind of fiscal support could be offered to them by EC?

III. Policy environment

3.1 Monetary policy

Markets already expect higher borrowing costs despite ECB's hesitancy. Eurozone borrowing costs have surged recently as ECB is expected to shrink its **stimulus programmes**, underscoring the challenge for policymakers in trying to cool inflation. **Germany's 10-year government bond yield** climbed above 1% for the first time since 2015. Italy's 10-year yield spread versus Germany, considered a barometer of political and economic risks in the euro area, climbed as high as 1.9 percentage. Frederik Ducrozet, a strategist at Pictet Wealth Management believes the "danger zone" for the spread between 10-year bond yields of Italy and Germany is above 2.5 p.p. This pain threshold might be higher today, say up to 3 p.p. for spreads because the prospects for nominal GDP growth are higher. Markets now expect the ECB will take its deposit rate from -0.5% into positive territory by the end of this year and to above 1% in 2023.

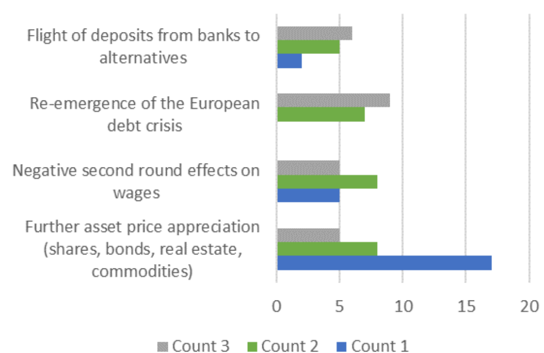
July's meeting could bring first interest rate hike. On April's meeting, governor Lagarde said that there was a high probability to stop adding to ECB's bond portfolio in Q3 2022 and after that they will decide about changes in interest rates. This opens the possibility of raising rates at the governing council's meeting on July 21. Tightening should be data dependent.

ECB becoming less supportive of monetising additional government debt. Eurozone governments are expected to issue almost as much extra debt this year as in 2021, but the ECB is due to purchase less of it. The market estimates the ECB would buy only 40% of net eurozone government debt issuance this year, down from more than 120% in the past two years. In Italy, net issuance of government debt is expected to be about EUR 80bn this year, slightly lower than last year, and the ECB is expected to buy about 45% of it, down from 140% last year.

Imported inflation becoming more an issue. ECB chief economist Philip Lane and executive board member Fabio Panetta have signalled they are now more open to raising rates in the coming months. This opinion came after it was clear April's EA19 HICP came at 7.5%. Lane was predicting in February 2022 that most inflation will fade away within 12 to 18 months, but recent figures changed his mind. Exchange rate developments are also a consideration behind future monetary decision as euro is at 5-year low compared to dollar what is driving up import prices.

Expansionary monetary policy becoming less suitable according to Institutes. Institutes largely expect (two thirds of them) the **monetary policy in EA19** to remain expansionary (15% that it will remain very expansionary). However, when asked about its suitability, only 40% believe that expansionary one is suitable. 35% of them believe a more restrictive is warranted and 25% that a neutral one would be the most appropriates.

Fig. 3.1.1 Please indicate the three higher risks you associate to the prolonged present monetary policy, and rank them from 1 to 3, being 1 the higher risk.

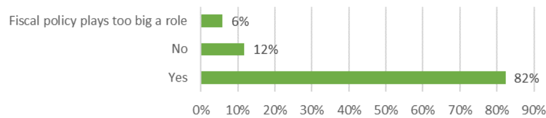


Source: AIECE Institutes

Asset price inflation a risk to economy. When asked about the **risks of prolonged expansionary monetary policy**, a large majority of Institutes is wary of further asset price appreciation. Second most cited risks are negative second round effects on wages,

whereas re-emergence of European debt crisis is less of a worry, probably also due to some hints from side of ECB on developing special instrument that will limit the rise of bond spreads between EA19 countries.

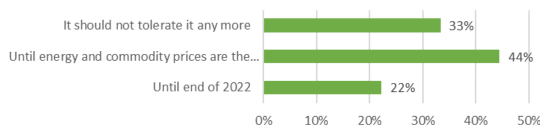
Fig. 3.1.2 Do you think the current balance between fiscal and monetary policy in your country is appropriate?



Source: AIECE Institutes

Majority of Institutes believe that the **current balance between fiscal and monetary policy** is appropriate and only one believes that fiscal policy play a too big role. When asked further about some negative effects due to low interest rates, 47% of them see some limited evidence (rising house prices, crypto frenzy, rising mortgage debt). A quarter of Institutes sees no negative effects and a quarter sees quite some evidence.

Fig. 3.1.3 How long should the ECB tolerate above 2% HICP inflation?



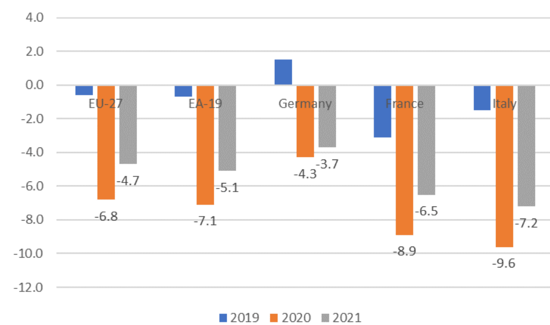
Source: AIECE Institutes

No consensus when the ECB should become less expansionary and more restrictive. Institutes are split between ECB tolerating price growth above 2% target. 44% believe that it should if energy and commodity prices are the driving factor. One third of them believes it should not tolerate it anymore and one fifth that end of 2022 should be the right time frame.

3.2 Fiscal Policy

Only gradual fiscal adjustment to expect by the EC in 2023. The necessary fiscal response to the COVID-19 pandemic and the contraction in output have resulted in a significant increase in government debt ratios, in particular in some high-debt member states, though without rising debt servicing costs. EC published its opinion on 2 March 2022 that gradual fiscal adjustment to reduce high public debt as of 2023 is advisable, while a too abrupt consolidation could negatively impact growth and, thereby, debt sustainability. Last ECFIN forecast was published on 10 February, two weeks before the invasion of Ukraine, which negatively impacted the growth outlook and tilted the risks further to the downside.

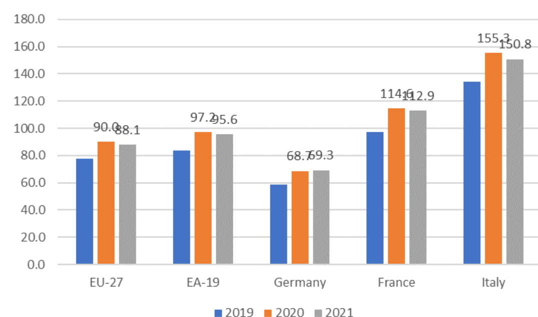
Fig. 3.2.1 Public deficit-to-GDP



Source: Eurostat

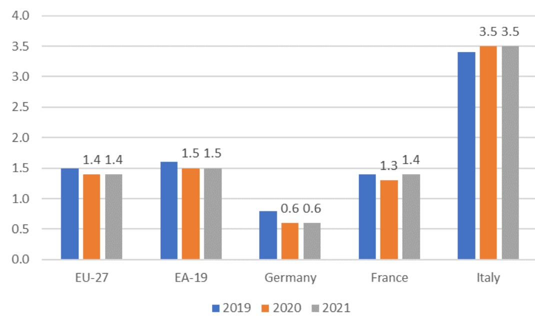
Decline in debt in deficit in 2021 primarily due to higher nominal growth in GDP. The EU's **government deficit-to-GDP ratio** decreased from -6.8% in 2020 to -4.7% in 2021. **Government debt-to-GDP** ratio fell from 90% in 2020 to 88% at end 2021. Differences across countries remain high. Estonia is the least indebted country (18% debt-to-GDP) and Greece the most (193% debt-to-GDP).

Fig. 3.2.2 Government consolidated gross debt-to-GDP



Source: Eurostat

Fig. 3.2.3 Interest paid-to-GDP

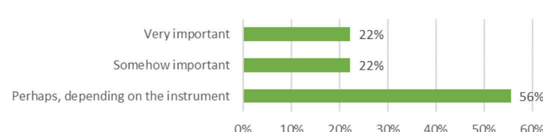


Source: Eurostat

Expansionary fiscal policy in 2022 a right one, but a neutral and somehow contractionary policy should be followed more often. Almost half of all Institutes expects an expansionary **fiscal policy in their country in 2022**, one sixth of them a neutral one and a fifth of them somehow contractionary. When asked about a **suitability of the fiscal policy**, somehow expansionary sounds a right one for the same share of Institutes. A higher share of them (30%) expects a neutral fiscal policy to be the right one and one quarter of them believes that somehow contractionary is the most appropriate. **For 2023**, Institutes are largely split between following somehow expansionary, neutral, or somehow contractionary fiscal policy.

Debt sustainability depends on market interest rates and nominal growth rates of economies. **Public debt in particular country is sustainable** if costs of borrowing remain below growth rate for more than half of Institutes. 40% of them believes that public debt is not even a relevant problem, but only one claims it is unsustainable in their country.

Fig. 3.2.4 Do you believe that coordinated measures at European level on challenges, brought by high energy prices and price disruptions of other commodities are working?

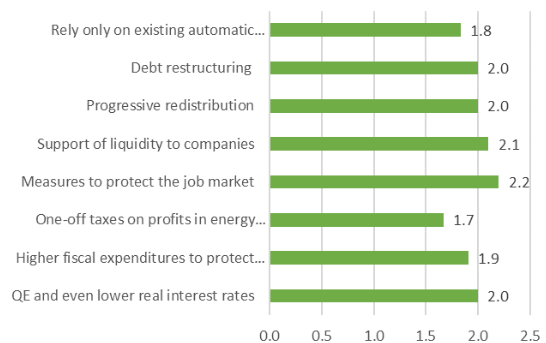


Source: AIECE Institutes

Scepticism around coordination this time higher than for Temporary framework. About a half of Institutes are sceptical about **coordinated measures at European level on challenges, brought by high energy prices and price disruptions of other commodities**. They believe they are somehow working, depending on instrument. One fifth of them believe they are somehow important; the same share claim they are very important.

Fiscal space is important to protect growth. Institutes believe that **differences across fiscal space somehow explain the differential in growth rate** (56% of them). One sixth of them believes in that very much but 28% of them do not see this as a factor.

Fig. 3.2.5 If growth decelerates substantially in the coming quarters, what would be an appropriate (but not necessarily feasible) response for your country? Please choose three, being 1 the most important.



Source: AIECE Institutes

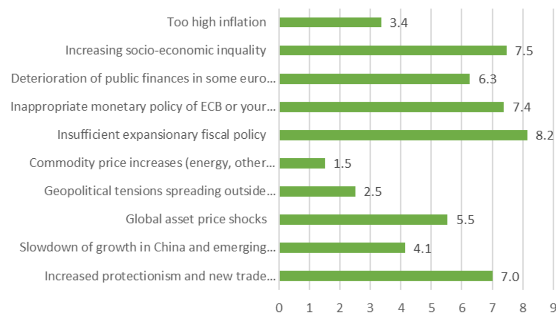
Taxing the beneficiaries of high energy prices. **If growth decelerates in coming quarters**, Institutes are quite split about the appropriate response in their own country. One-off taxes on profits in energy sector and their distribution to consumers did come on the top of priorities, closely followed by relying on existing automatic stabilisers. Institutes are also prone to suggest higher fiscal expenditure to protect consumer power.

Questions for discussion

1. How long will the credit condition remain favourable for private sector and households? What is the approximates breakeven 3-month Euribor and 10-year bund that would signal a turnaround in loan dynamics for EA19?
2. If asset prices decline more due to anticipation of monetary policy tightening (as currently tech stock) could that create negative wealth effect and negatively affect the consumption of European households? Is this more the case of USA vs European households or are there some differences among European nations as well?
3. Could reduction in house prices from current highs due to more restrictive monetary policy dent into consumer sentiment and to household consumption?
4. How likely is it that EC again (for 2023) suggests member states using general escape clause already in May after release of its Spring report?
5. Is ECB likely to commit sufficient monetary resources on time to limit possible increase in sovereign bond spreads that may happen if the market starts anticipating fiscal policy will remain expansionary in 2023? Is there expected any serious split among member states this time?
6. Are increased spending for defence included yet in fiscal planning in 2022 and 2023 in your countries?

IV. Risks and special questions

Fig. 4.1 What are the main downside risks to your projection for growth in Europe up until 2022? Please evaluate them according to their importance from 1 to 10, being 1 the most important.



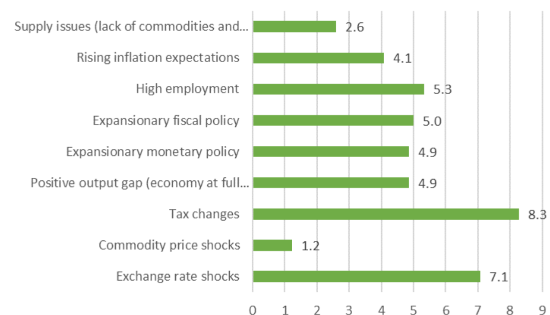
Source: AIECE Institutes

Quite homogenous risk assessment across Institutes. The **main downside risk to Institutes projections of economic growth in their own country** are quite similar across countries. Increased oil and energy prices and lack of their supplies (and supplies of other commodities and supply parts) remain by far the most common risk. This is followed by geopolitical tensions spreading to other countries. COVID-19 pandemic was mentioned only by one Institute as a risk.

European downside risks are energy costs and geopolitics. The main **downside risk to European growth** should likely have same roots as the one for domestic growth. That is commodity price increases (energy, other commodities) and geopolitical tensions, spreading outside Ukraine to neighbouring countries. Too high inflation was also commonly cited.

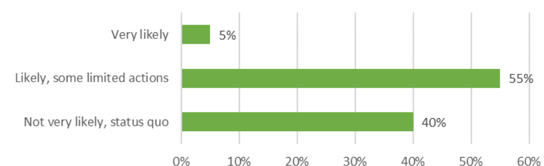
High energy prices and supply chain issues causing inflation. Commodity price shock was overwhelmingly number one cited **cause of strong inflation outlook in Europe** by majority of Institutes. Supply induced inflation (delays in shipping, production parts) is cited as the second most common.

Fig. 4.2 What are the main causes of the strong inflation outlook in Europe? Please rank from 1 to 9, being 1 the most important.



Source: AIECE Institutes

Fig. 4.2.3 Do you expect the labour relations between employees and employers will become more intense over time (probability of strikes, union protests etc.)



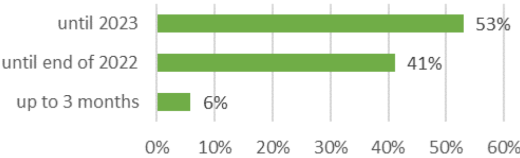
Source: AIECE Institutes

Social dialogue not becoming very destructive due to inflation. When asked about **labour relations between employers and employees** (unions), they should not become very intense over time. Majority of Institutes see some limited actions of unions due to rising inflation and wages that are not keeping up the pace, and 40% of them believe a status quo is warranted.

Reshoring trendy, but lack of any important facts. **Reshoring and shortening of supply chains** is again becoming more of an issue for European companies, especially for large multinationals that built their model around cheap production from Asia. Higher shipping costs and delays in transport, together with rising labour costs in China have prompted some companies to look for supplies closer to their production, at least to diversify some risks from lack of supplies. One third of Institutes believes that reshoring will not benefit the future output of Europe, but almost half of

them believes it will somehow increase it. Only 18% of them have very ambitious expectations. When then asked about whether they already see some positive effects in their own country, majority of them see negligible effects.

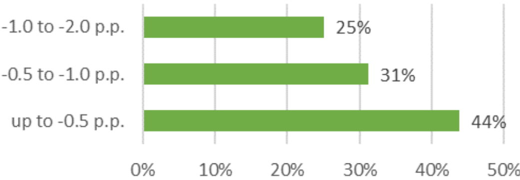
Fig. 4.2.4 How long do you expect this conflict to have a strong negative economic effect on EU27?



Source: AIECE Institutes

Economic pain to last at least until end 2022 for home country, until 2023 for Europe. War in Ukraine prompted us to ask Institutes about its effect on growth, inflation and effect of embargo/sudden stoppage of supply. Half of Institutes expects the conflict to have a strong **negative economic effect in their own country until end of 2022**. One third of them that the economic pain will last until 2023. **With regards to EU27**, negative effect will be prolonged (53% respondents claim that until 2023).

Fig. 4.2.5 What is your best estimate on the effect of conflict on real growth rate in your country in 2022?

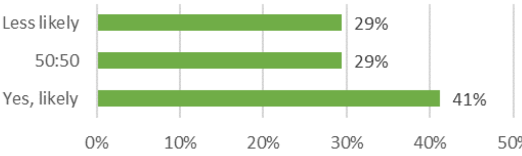


Source: AIECE Institutes

About 0.7 p.p. a central downgrade due to war in Ukraine. War in Ukraine and its consequences prompted Institutes to **reduce their own country's growth rate** by 0.5 p.p. or less (44%) and 31% of them made a larger adjustment (between 0.5 and 1.0%). A quarter of them reduced the growth rate between 1 and 2 p.p..

Estimates of growth in EU27 more pessimistic than for its own country. Institutes were more pessimistic **about EU27 growth** as half of them subtracted 1-2 p.p. off the growth rate and one third of them between 0.5 and 1.0 p.p.

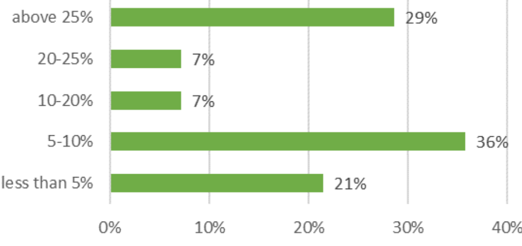
Fig. 4.2.6 Do you expect a sudden reduction of flow of natural gas to Europe from Russia in 2022?



Source: AIECE Institutes

Halt of natural gas flows not so odd at all. Sudden reduction of natural gas to Europe would be an expected scenario by about 40% of Institutes. The rest are split between 50:50 odds and a less likely scenario.

Fig. 4.2.7 What's the approximate share of private sector in terms of value added in your country that would be hurt by sudden stoppage of delivery of natural gas from Russia?



Source: AIECE Institutes

Different outcomes across private sector due to natural gas scenario. This scenario would have a quite heterogenous effect across countries. A good third of Institutes believes that 5-10% of **private sector in terms of value added would be hurt**. A bit less (29%) claims a quarter of private sector would suffer. One fifth believes that less than 5%.

Questions for discussion

1. Is it warranted that Institutes put so little weight on COVID pandemics next waves as a risk to the outlook? Does not the current situation in China prompt experts to reconsider the negative effects on Europe in autumn?
2. Due to expansionary fiscal policy and high savings, households/employees are not yet feeling the pinch of rising food and energy prices. Is it possible these changes when the positive effect of stimulus fades away? Is this possible a time when unions gather power for mass movements and try to enter the agendas of established political parties across Europe?
3. Do you expect some limits on consumption of oil derivatives in autumn/winter 2022 as in 70s due to embargo?
4. Do you expect the prolongation of life of thermal and nuclear plants in Europe is already properly accounted on general energy markets?
5. Will removal of restrictiveness measures in China add pressure on global energy prices (especially crude oil and LNG)?
6. Are Ukrainian refugees adding to the potential labour force in countries that accepted a majority of them?

Sources

Eurostat, S&P Global, Financial Times, Investing.com, AIECE questionnaires (25 of them returned between 6 April and 2 May 2022)

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